# THE RELATION OF THE UNITED STATES TREASURY TO THE MONEY MARKET

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The federal treasury touches the money market in two ways. In its fiscal operations under the independent treasury law it withdraws from circulation the money received in payment of taxes and dues of all kinds and disburses these receipts in making its payments at times and under conditions which have a reference only to its fiscal operations, and none whatever to the currency needs of the business community. In its simplest form the independent treasury is the recipient of a constant stream of money of varying dimensions, like a reservoir as it were, out of which the stream is permitted to flow again only at intervals, and in a volume that has no relation to the volume of the inflow.

Through modifications of the law, however, made from time to time in the past sixty years, the independent treasury has been used by various secretaries of the treasury, either of their own initiative or under pressure from the banking interests of the country, as a means of controlling the currency supply; that is, of giving to our currency supply the much desired and much debated quality known as "elasticity". It is this latter function which has become of paramount importance in recent years, and to which I shall invite attention in a moment.

In its operation as a fiscal institution, the independent treasury has often been described and is familiar to all of

you. The principal objection to it, as has been already intimated, is that it withdraws money from circulation and disburses it again without any reference to the demands of the business community. Consequently, it has, at times, locked up currency when more was needed by the people, and has disbursed it when less was needed. At times, indeed, we have been more fortunate, and treasury intake and disbursement have coincided with the increased need and lesser demand, respectively. So far as the legal operation of the fiscal department of the government is concerned, however, such an occurrence is a happy accident.

The evil thus caused was seen early in the operation of the independent treasury law, and measures taken to mitigate it. It is not necessary at this time to go into the details of the measures taken from time to time for this purpose. In the earlier days they included the purchase of government bonds by the treasury at high premiums, and the prepayment of interest on the government debt. Later the provision of the national banking law authorizing the deposit of the receipts by internal revenue collectors in national banks enabled the secretary of the treasury to lessen the irregularity in contraction and expansion due to revenue operations. Until within a few years these three methods were the only ones employed or regarded as legal for preventing the independent treasury from disturbing the money market. While the revenues of the government yielded little or no surplus they were sufficient. It is clear, however, that the larger the surplus the greater the disturbance that will be caused by locking it up.

Now, our revenue system is of the same happy-go-lucky kind as our fiscal machinery. We may almost say that our taxes are devised by one set of men, our expendi-

tures by another, without any connection with the former group, and that the actual amount of revenue received depends more upon the influence that can be exerted by the representatives of "proper" interests in our country than by the real needs of the government. Like certain gentlemen in romance, we get all we can and spend all we get, without asking whether what we get is a proper and reasonable amount for running the government or whether what we spend is wisely spent.

Now, it happens that in the past forty years we have had deficits only nine times, while in the other thirty-one years the annual surplus has ranged all the way from 2.3 millions of dollars in 1893 to 145 in 1902.

The larger the surplus the larger the amount of money withdrawn from circulation and the greater the necessity for getting it back. In the absence of occasion for paying government debts with it, it can be gotten back only by depositing it in the national banks. No equalization of government disbursements from month to month throughout the year can do away with the mischief caused by surplus financiering and the consequent withdrawal of a large amount of money from circulation and its arbitrary distribution among the banks. Nor can the surplus be used as hitherto, in the earlier days, for the redemption of government bonds, because this redemption would cause a diminution, or at least prevent further expansion, of the national bank currency.

In the face of these difficulties, which have been growing greater with the larger surplus revenue, the past few years have seen a change in the interpretation of the law by the secretaries of the treasury in their efforts to prevent the evils spoken of. As has been already remarked, in the early days of the independent treasury law the only means at the command of the secretary of the treasury

to mitigate the disturbance of the money market caused by locking up the government income, were the anticipation of payments of the national debt, prepayment of interest and permission to allow internal revenue to find its way into banks instead of directly into the treasury. In the past half dozen years the secretaries of the treasury have expanded their powers, and, instead of attempting, as formerly, simply to minimize the disturbance caused by the independent treasury, they have turned it into an active agency for the regulation of the currency supply of the money market. From being the direct and final lodging place for government money which it was designed to be by the constitution, the independent treasury, under the national banking act, became also, in part, the final reservoir of a current of money flowing through the national banks. Under Mr. Secretary Shaw in these latter years it was made a reservoir from which streams of money could be poured into the banks after it had reached its constitutional resting place. It is only within a few years that any secretary of the treasury has ventured to take money already in the treasury and deposit it in the banks. By so doing the secretary of the treasury has arrogated to himself the complete control of the elasticity of our currency. He has made deposits when he thought the money market was stringent or likely to be so; he has withdrawn them when he supposed the contrary condition prevailed or would prevail. In other words, a man not engaged in business has undertaken to control the ebb and flow of the means of payment. If his judgment were always sound as to the occasions for interference, it is doubtful whether it ever could be as to the extent of interference necessary or desirable. In other words, the extension of the practice of depositing government money in the banks is an attempt to do by arbitrary

or mechanical means what ought to be left to come about as the result of business operations. It is a power of too great potential danger and misuse to be left to any officer or any individual.

As we have seen recently, the practice arouses criticism and suspicion among the public and gives rise to charges of favoritism among the banks. Moreover, the feeling on the part of the banks that the government money is available if they can convince the secretary of the treasury of its need, militates against care on their part. When a stringency occurs banks are likely to rely on the government so much as to prevent their taking measures for the early restoration of the natural correctors of the disturbance. As Mr. Andrews has put it in his recent admirable article on the subject in the *Quarterly Journal of Economics,* the practice "tends to check appropriate measures of precaution and to hinder natural methods of relief".

The authority conferred upon the secretary of the treasury by law, or, to speak more correctly, the interpretation of the law by Mr. Secretary Shaw, for the administration of the independent treasury, has been used to open up still other methods of interference with the money market. Besides buying bonds, prepaying interest, permitting deposits to be made by collectors of internal revenue, and, finally, by depositing in the banks money once in the treasury, Mr. Shaw interfered further by accepting other than government bonds to secure the public deposits, an authority which was afterwards confirmed by law. The secretary has attempted to relieve the depositary banks also by informing them that they need not keep reserves against their holding of public funds, thereby releasing the reserves thus previously held to sustain their liabilities. The secretary has further

virtually paid banks for importing gold by a device which allowed them the interest on the amount imported from the time the order for the importation was placed until the time of its receipt.

We have seen the secretary of the treasury, moreover, actually try to control the existing amount of currency, and thus impart to it the elasticity it so much needs by withdrawing and disbursing large sums in anticipation of market conditions, on his own initiative, and on his own judgment. Having accepted other than government bonds to secure public deposits, he has insisted that the government bonds thus released should be made a basis for increasing the amount of national bank notes.

It is hardly necessary to comment on the dangers that such a power in the hands of one man causes for the business interests of the country. Such a species of paternalism puts prudence at a discount, stimulates the speculative spirit, endangers the public money, and vitiates respect for the authority of the law, to say nothing of the vicious evils of favoritism and prejudice to which it gives rise.

Thus we see that, in the sixty years of its existence, the independent treasury has become an institution of a very different character from what its creators intended. In 1846 it was the depositary of the public monies, intended to keep them safe from the manipulation of the banks. In 1861 it established a permissible but slight connection with the banks. In 1903 we find the law interpreted so as to take money actually already in the treasury for deposit in the banks, and from then until now we see the independent treasury made an active and dominating factor in determining the volume of money in circulation, in other words, the elasticity of the currency.

In the past few months we have seen the scope of inter-

ference of the government in the money market still further extended by the issue of interest-bearing treasury notes at a time when the government revenues were not only ample for its expenditures, but showed a large surplus; and the increase of our national debt for a similar purpose.

In the face of the evils that such arbitrary interference in so many ways has caused, it is somewhat surprising to find the independent treasury defended by so able an authority as Mr. F. A. Cleveland. He insists that it is not true that the money in the vaults of the government is taken out of circulation. He emphasizes the help which the disbursement of the treasury gives to the money market at those times when they are accidentally made at opportune times. He objects to the deposit of the government funds in banks on the ground that this may increase monetary disturbances. He insists that the independent treasury increases the national money supply, that its periodic intake and output concur with the times of surplusage and need in the money market![1]. All that need be said with reference to these arguments is what has already been remarked, that the facts show that such a concurrence of treasury operations and money market needs is infrequent; that the system is liable to mistake and abuse, and that at its best it is arbitrary and mechanical.

The most important part of the remedy for the evils of the independent treasury as a fiscal institution is the wiping out of the surplus revenue, and the adoption of a budget which will leave on hand approximately only the necessary working balance for government expenditures. On that I need not enlarge.

The second step is that this working balance of from twenty-five to fifty millions, as it may be, shall be kept in

the banks by the government, secured by bonds and treated like any other deposits, to be checked against by the government when needed. The secretary should be required, and not merely permitted, to keep the government money in banks under proper conditions. If there is a surplus revenue he should be required to treat all the banks equally in the matter of deposits, instead of showing favoritism, as is alleged to have been done by a recent secretary. In short, the independent treasury should be abolished.

The abolition of the independent treasury would not and should not mean, however, the complete abolition of government influence in the money market. The passing of that institution is desirable because it is a bad fiscal agency, and because it opens the way to, if, indeed, it does not make necessary, unwise and illegitimate interference with the money market.

Under our system of currency, however, it is undesirable, and, indeed, impossible, for the government to withdraw entirely from participation in the regulation of currency. Great emphasis has been placed in late years upon the necessity for securing elasticity of the currency, and perhaps we have never felt the need of that element so keenly as in the past two or three months. What is called our deposit currency has the element of elasticity in a high degree. The money part of our currency, however, does not have it at all. Any proposals to secure this element, to be practicable, must have regard to the character of our monetary system.

Looking at the matter in a broad way, the interests of the banks and those of the public are, in one sense at any rate, the same. The promotion and protection of the one should therefore imply the promotion and protection of the other. Unfortunately, in banking, as in many other

lines of business, this optimistic view has not been borne out by experience. Not infrequently important banking institutions have followed their own interests at the expense of the public. We are justified, therefore, in scrutinizing closely proposals for alleged reform in our banking and fiscal procedure, if they emanate from the banking interests of the country and look to radical reconstruction of existing institutions. There is no doubt that many banking interests would be glad for their own purposes to be wholly untrammeled, either by the fiscal operations of the government, or by its supervising control. They urge the specious plea that competition, if left to do its perfect work, will give us the best banking system and the best currency; that the government when it interferes does only mischief, and that the solution of the whole currency situation should be left to the practical men of experience. The plea is specious for three reasons. The first is that competition left unrestrained is at least as likely to prove maleficent as beneficent. The second is that government interference and certain government supervision is not necessarily an evil; and the third reason is that the men of large experience engaged in practical affairs are just as likely to have their vision clouded by the dust raised by their own activity and personal interest as the disinterested student is to be led astray by his ignorance of practical details. For these reasons we can not give way too readily to the demand of banking institutions, which is growing more insistent with the passing years, that the control of our monetary situation be left entirely with the banks, and that the government withdraw its influence altogether from this field.

When we are pointed to the banking system of Canada, Scotland, or France, or even Germany or England, as models for us to follow, we must not forget that condi-

tions in each of these countries are very different from ours. We have no banknotes, properly so called. The national banknote is an indirect government issue. For nearly half a century we have been developing the policy of getting on without banknotes scientifically so called, and making all our currency directly or indirectly the creation of the government. Suggestions for reform or amendment must either propose the abandonment of this kind of paper issues and the substitution of banknotes proper, or they must take for granted the exclusion of the banknote from our system, or, in the third place, like the American Bankers' plan, they must propose a mixture of the two. We cannot abandon entirely and at once the system of bond-secured banknotes, and for two very good reasons. One is that the people will not have it, and the other is that the banks will not have it. To do so would throw a vast mass of government securities upon the market and cause a depreciation which would entail a heavy loss upon the banks. We must therefore retain our peculiar kind of note, and provide elasticity to our system either by making their issue easier and their current redemption easy, constant and necessary, or we must add to the inelastic volume now possible an issue of notes of the kind known as asset currency. For my own part, I see no good reason for abandoning our present system, if it can be shown that the desired elasticity can be secured under it. I believe that our people will still continue to insist that our paper currency shall be directly or indirectly issued by the government; that is, in popular phrase, that it shall have the credit of the government behind it, or be backed by the government.

With this view, it is my opinion that the most practicable mode of providing for elasticity is by an emergency currency secured by the banks from the government on

proper security, and with proper provisions to enforce its current redemption. If the banks are allowed to issue notes against their general assets one result will be the substitution of notes for a large proportion of their deposits. They will push to the limit any advantage that they can get by increasing the issue of such notes, and we shall be always on the verge of an inflation of bank-note currency. The times and degree of expansion and contraction required by business should be determined by the banks under the pressure of business demand, but regulated and provided for by the government. In other words, when there is an increasing demand for money in any part of the country, the banks which feel this demand should be able at once to secure additional notes by the deposit of adequate security, and these notes should be so heavily taxed that it will not pay the banks to keep them out after the pressure for the money slackens.

In times of pressure like the present, the real difficulty is that the so-called unincumbered and convertible securities of the banks cannot be sold. If they could be, there would be no difficulty in supplying currency. If a means can be provided to furnish currency on the basis of these securities, the needs of the situation would be met just as truly and as well as if the banks were allowed to issue notes without such security.

It is impossible, in the time at my disposal, to go fully into details as to how I think this should be accomplished. I should say in brief, however, that, in my judgment, it could be done by dividing the country into clearing house districts, compelling all banks of issue to be members of the clearing house of its district, making these clearing houses for this purpose agents of the government, and changing the national banking law so as to permit the issue of notes on the basis of securities approved by the

clearing house association, precisely as clearing house checks were issued in the past month or two, but subject to a heavy fixed tax, or to one graded according to the average rate of discount in the clearing house district.

If I may summarize the points that I have tried to make, and include in the summary the provisions which, in my judgment, should be made for the federal clearing house project, they would be as follows:

1. We should abolish the independent treasury as the fiscal machinery of the government.

2. We should reconstruct our budget and give up the system of surplus financiering with all its mischievous interference with business and invitation to extravagant expenditure.

3. We should require, not merely permit, the secretary of the treasury to keep the current balance of the government on deposit in such national banks as best suit the convenience of the government in making its payments. If the government deposits were reduced to current balances, the opportunity for charges of favoritism in selection of banks would fall away. Having done away with the interference of a bad fiscal system in the money market, the government should undertake, in keeping with the character of the American system of currency, to provide means for securing elasticity by dividing the country into clearing house districts, with at least one federal clearing house in a district acting as an agent of the government for the scrutiny and acceptance of securities to protect U. S. deposits and emergency issues of notes.

4. Any national bank in a clearing house district may deposit any approved securities with said clearing house and receive in return notes upon an appropriate per cent. of the value of the security.

5. These notes should be in form and appearance like the ordinary banknotes, since a distinct form of note for emergency purposes disturbs confidence.

6. These notes should be issued at a rate of discount slightly above market rate at any time, the net proceeds of the discounts to be covered into the treasury.

7. Make these notes redeemable currently in lawful money at selected centers in the clearing house district, the banks of issue, and selected centers in other clearing house districts.

8. For the retirement of these notes permit the bank that issues them to deposit gold or legal tender with the clearing house or the sub-treasury of its district, and receive back its securities, either all at once or in stated proportions, as the bank chooses.

9. Keep this deposit of gold or legal tender as a trust fund for the redemption of these notes only.

10. Repeal the provision of the present law which permits country banks to keep part of their reserve in reserve cities.

11. Repeal the provision of the present law limiting the retirement of banknotes to a certain amount per month.

The three salient points, therefore, are:

The abolition of interference by fiscal machinery.

The preservation of our present system of currency; and

The provision under it for elasticity.